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SUBJECT: CANADA'S AUTO SECTOR -
ON CLIMATE CHANGE POLICY'S FRONT LINE

REF: (A) OTTAWA 0822 (B) TORONTO 0430

SUMMARY/INTRODUCTION

1. WHILE THE GOC WORKS TO ENGAGE THE U.S. TOWARD FORMING A POST-KYOTO STRATEGY ON CLIMATE CHANGE, IT HAS YET TO IMPLEMENT A CREDIBLE PROGRAM FOR MEETING ITS KYOTO TARGETS BY 2012. MEASURES AFFECTING GREENHOUSE GAS EMISSIONS FROM NEW MOTOR VEHICLES ARE MEANT TO BE A KEY FEATURE OF THIS PROGRAM, BUT A "VOLUNTARY" AGREEMENT WITH AUTOMAKERS HAS BEEN REPEATEDLY DELAYED. FOR THE GOC, THE ALTERNATIVE COULD BE TO PASS MANDATORY REGULATIONS, PERHAPS IN LINE WITH THOSE PROPOSED BY CALIFORNIA.

2. ON A SLOWER TRACK, THE GOC IS ALSO CONSIDERING A "FEEBATE" SCHEME WHICH WOULD SUBSIDIZE THE SALE OF FUEL-EFFICIENT VEHICLE MODELS AND TAX "GAS GUZZLERS." END
SUMMARY/INTRODUCTION

MARTIN'S BIGGEST ECONOMIC CHALLENGE

3. FORMER PRIME MINISTER JEAN CHRETIEN'S 2002 COMMITMENT TO RATIFY THE KYOTO PROTOCOL IS NOW ONE OF THE BIGGEST ECONOMIC POLICY PROBLEMS FACING HIS SUCCESSOR, PAUL MARTIN. RECENT BUDGETS HAVE ALLOCATED LARGE FISCAL RESOURCES (SOME C\$6 BILLION, OR US\$5 BILLION, BY 2010) TOWARD REDUCING GREENHOUSE GAS EMISSIONS - FOR EXAMPLE, BY SUBSIDIZING BUILDING RETROFITS. WHILE THIS WAS RELATIVELY EASY, GIVEN THE GOC'S STRONG BUDGET POSITION (AND THE RANGE OF POSSIBLE SPENDING THAT CAN POTENTIALLY BE COVERED), REPORTS NOW SAY THAT FEDERAL OFFICIALS ESTIMATE THAT THIS IS ONLY HALF THE COST REQUIRED TO REACH THE TARGETS, BECAUSE TIME HAS BECOME SO SHORT.

4. DECIDING WHAT MEASURES WILL BE IMPOSED ON VARIOUS INDUSTRIES HAS PROVEN FAR MORE DIFFICULT. ONE MAJOR REASON IS CANADA'S PROFOUND DEGREE OF ECONOMIC INTEGRATION WITH THE UNITED STATES, AND ITS NEED TO MAINTAIN A COMPETITIVE BUSINESS ENVIRONMENT. ANOTHER IS THE DEPTH OF INTER-PROVINCIAL DIVISIONS IN CANADA, WHICH MEANS THAT THE GOC'S RELATIVE TREATMENT OF DIFFERENT INDUSTRIES (E.G. OIL AND GAS VS. MANUFACTURING) HAS NATIONAL POLITICAL REPERCUSSIONS.

"VOLUNTARY" DEAL ON AUTO STANDARDS DELAYED

5. TRANSPORTATION LED THE LIST OF "KEY AREAS FOR ACTION" IN THE 2002 CLIMATE CHANGE ACTION PLAN FOR CANADA (SEE WEBSITE CLIMATECHANGE.GC.CA). THE PLAN CALLED FOR A 25 PERCENT INCREASE IN VEHICLE FUEL EFFICIENCY BY 2010, PLUS ADDITIONAL STEPS TO ENCOURAGE CONSUMER DEMAND FOR MORE FUEL-EFFICIENT VEHICLES, THE USE OF ETHANOL AND BIODIESEL FUELS, AND USE OF PUBLIC TRANSPORTATION. (ANOTHER "KEY AREA FOR ACTION" - A PLAN TO MANAGE "LARGE FINAL EMITTERS" (LFE'S) - IS ALSO CURRENTLY NEAR COMPLETION AND WILL BE REPORTED SEPTTEL).

6. TALKS BETWEEN THE GOC AND THE AUTO INDUSTRY ON NEW VEHICLE STANDARDS HAVE BEEN ONGOING SINCE 2002. DURING 2004, APPARENTLY INSPIRED BY LEGISLATION IN CALIFORNIA, THE GOC SHIFTED ITS TARGET FROM FUEL EFFICIENCY TO CARBON EMISSIONS. WHILE IT IS NOT YET CLEAR WHETHER CALIFORNIA'S LAW WILL SURVIVE A LEGAL CHALLENGE IN THE U.S., GOC ENVIRONMENT MINISTER STEPHANE DION HAS STRENGTHENED HIS GOVERNMENT'S HAND IN THE TALKS WITH INDUSTRY BY HOLDING OUT THE THREAT OF SIMILAR MANDATORY RULES IN CANADA - WHICH, LIKE CALIFORNIA, REPRESENTS OVER 30 MILLION CONSUMERS - IF A VOLUNTARY DEAL FALLS THROUGH.

NEW VEHICLE "FEEBATE" BEING STUDIED

7. IN ITS 2005-06 BUDGET ANNOUNCED IN FEBRUARY, THE GOC

ANNOUNCED PLANS TO CONSIDER INTRODUCING A "FEEBATE" SCHEME FOR NEW VEHICLE SALES. THIS WOULD CONSIST OF REBATES FOR PURCHASERS OF THE MOST FUEL-EFFICIENT MODELS, AND ADDITIONAL TAXES ON "GAS GUZZLERS." THE NATIONAL ROUNDTABLE ON ENVIRONMENT AND THE ECONOMY (NRTEE) WILL STUDY AND MAKE RECOMMENDATIONS ON THIS OPTION FOR POSSIBLE INTRODUCTION IN THE 2006-07 GOC BUDGET.

18. INDUSTRY REPRESENTATIVES SAID THEY WERE SURPRISED BY THE "FEEBATE" PROPOSAL. THEY HAD BEEN HOPING INSTEAD FOR A SIGNIFICANT REBATE (PERHAPS C\$2000) ON SALES OF HIGHLY FUEL-EFFICIENT "HYBRID" CARS, WHICH DID NOT MATERIALIZE. ONTARIO, CANADA'S LARGEST PROVINCE, RAN A "FEEBATE" PROGRAM DURING THE 1990'S WHICH WAS EVENTUALLY RESCINDED BECAUSE IT HAD BECOME LITTLE MORE THAN AN UNPOPULAR TAX ON NEW VEHICLES. THE GOC PROPOSAL MERELY NOTES THAT ITS SCHEME "COULD BE REVENUE-NEUTRAL."

19. COMMENT: IN THIS CONTEXT, THE "FEEBATE" IDEA RAISED ALARMS IN THE AUTO INDUSTRY, AS IT SUGGESTED THAT THE GOC MIGHT BE INCLINING SOMEWHAT MORE TOWARD PUNITIVE, TAX-RAISING MEASURES RATHER THAN REWARDING INNOVATION. END COMMENT

CONCLUSION/COMMENT

110. AN ANNOUNCEMENT OF A VOLUNTARY CARBON-EMISSIONS DEAL HAS BEEN CONSIDERED "IMMINENT" FOR MONTHS. EVIDENTLY, ENVIRONMENT MINISTER DION HAS BEEN HOLDING UP THE INDUSTRY FOR ADDITIONAL CONCESSIONS. DION IS A FIERCE NEGOTIATOR WHO WAS FIRST RECRUITED INTO GOVERNMENT TO BATTLE PROVINCIAL SEPARATISTS IN QUEBEC. HIS STRENGTH IN THE TALKS SO FAR, FOLLOWING HIS SUCCESS IN SHIFTING THE TARGET FROM FUEL EFFICIENCY TO CARBON EMISSIONS, REFLECT A NEW IMPORTANCE FOR A CANADIAN ENVIRONMENT MINISTER IN POLICY AREAS WHICH WERE TRADITIONALLY RUN BY COUNTERPARTS IN NATURAL RESOURCES (ENERGY AND FUELS) AND INDUSTRY (AUTOS AND PRODUCT STANDARDS) - INDEED, A NEW IMPORTANCE FOR AN ENVIRONMENT MINISTER IN GOC ECONOMIC POLICYMAKING. END COMMENT.

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